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Second-tier Cities Offer First Rate Sales Opportunities

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Report Highlights:

China's second-tier cities, many of which have more residents than the largest U.S. cities of Los Angeles or New York, boast growing populations, increasing disposable incomes, upscale retail development, savvy e-commerce customers, and improved cold chain and distribution networks. China now has over 600 cities that fall somewhere within the tier system, and many of these cities are untapped treasures for U.S. agricultural exporters. U.S. exporters are encouraged to develop a second-tier marketing strategy that works well for their products. This report outlines a four part strategy that will benefit those seeking to enter these dynamic new markets. Each city is unique, so exporters are encouraged to inquire about specific opportunities and regional variability with FAS Agricultural Trade Offices in Guangzhou, Chengdu, Shanghai, Beijing, and Shenyang.

¹ Special thanks to the Foreign Agricultural Service staff across China for contributing to this report.

Second Tier Cities – What's the Big Deal?

While first-tier cities will always be important markets for exporters, second-tier cities should be considered essentially new markets for U.S. food and agricultural exports. In many cases these second-tier city economies rival the gross domestic product (GDP) of other countries. According to one report¹, the GDP of the east coast second-tier city of Suzhou is equal to Portugal, the port city of Qingdao's GDP is equal to Bangladesh, and the northeast city of Shenyang is comparable to Peru's GDP.

While the tier system has never been officially endorsed by the central government, it has been used informally to allocate government resources and infrastructure development, with first-tier cities receiving greater investment than lower-tier cities. To classify cities according to tiers, analysts typically use population, GDP, and political administration as the three main factors (Table 1). Cities with the largest population, GDP, and independent political administration are considered first-tier cities, which would include Beijing, Shanghai, Guangzhou, and Shenzhen. Those with a large population but lower GDP, or higher GDP but a relatively smaller population, are usually classified as second-tier cities.

Table 1. Tier Classification

	First-tier	Second-tier	Third-tier	Fourth-tier
Population	> 15 million	3-15 million	150,000 to 3 million	< 150,000
GDP	> \$300 billion	\$68-300 billion	\$18-67 billion	<18 billion
Political Administration	Central government controlled	Provincial or sub-provincial capitals	Prefecture capital cities	County-level cities

*Source: South China Morning Post*²

It is important to note that tier rankings are an imprecise way of describing the true market potential for these cities. Local and provincial governments have been known to inflate economic data to achieve official growth targets³ or attract private sector investment. Tier rankings also generally do not take into account major factors that drive consumer oriented food consumption, such as consumer purchasing power, middle class size, or regional cold chain developments. Nonetheless, the system does serve as an easy point of reference to understand where market opportunities may arise.

Why Should Exporters Invest in Second Tier Cities?

Predicting market demand and middle class growth is difficult, however there are several reasons why first-tier city consumers may slow their purchases of imported food products in the future. Population growth is increasingly shifting away from first-tier cities, and the cost of living in these cities continues to rise disproportionately to income. In 2002, 40 percent of China's urban middle class lived in just four first-tier cities. By 2022, it is estimated that only 16 percent will live in these first-tier cities⁴. U.S. food exports face fierce competition in first-tier cities, which are already well supplied with imported foods. Many of these food imports come from countries that China has bilateral trade agreements with, and therefore come in with low or no import duties, such as New Zealand, Peru, Chile, and Australia.

¹ <https://www.businessinsider.com/china-cities-economies-bigger-than-countries-2017-11>

² <http://multimedia.scmp.com/2016/cities/>

³ For example see: <https://www.forbes.com/sites/salvatorebabones/2018/02/12/china-quietly-releases-2017-provincial-gdp-figures/#5401f8ec20dc>

⁴ <https://www.mckinsey.com/industries/retail/our-insights/mapping-chinas-middle-class>

On the other hand, second-tier cities offer largely untapped opportunities for U.S. food and agricultural exports. Second-tier cities are attracting more residents due to lower real estate prices and education costs, flexible new resident policies, and government incentives for new college graduates. According to the central government's 2018 College Graduate Employment Report, since 2013, recent graduates choosing to work in first-tier cities declined by six percent, while those choosing second-tier cities increased by four percent. Many second- and third-tier cities have relaxed their *hukou* (household registration) policies by streamlining registration for new residents and their children. Residents moving to these cities are younger and more likely to have children; a key demographic for food processors and the imported food retailers. There are now over 100 cities in China with more than one million residents. To better understand the potential power of consumers living outside first-tier cities, consider the U.S. Embassy in Beijing consular district, which includes the cities of Beijing and Tianjin, and the provinces or autonomous regions of Hebei, Henan, Shanxi, Shaanxi, Qinghai, Xinjiang, Inner Mongolia, Gansu, and Ningxia. This region has 495 million potential consumers, yet only 25 million, or five percent, live in the Beijing metropolitan area.

Second-Tier Market Entry Strategy

1. *Develop a second-tier marketing strategy that works well for your products.* Second-tier cities can differ significantly with respect to consumer tastes, cold chain capabilities, e-commerce trends, and hotel, restaurant, and institutional (HRI) opportunities. Statistics rarely adequately describe these quickly evolving cities, so plan on visiting a few cities to get a feel for the market and local consumer preferences. Find cities and/or a region that work well for your products. For example, fresh fruit exporters should ensure adequate cold chain storage and wholesale infrastructure, while tree nut and fresh seafood exporters should explore the city's HRI (e.g., bakery) and e-commerce capabilities. Exporters should research and meet with potential partners including local importers and distributors, retail chain and HRI purchasing managers, local industry and trade associations, and e-commerce platform sales representatives.
2. *Begin by focusing small.* China is a large country where consumer behavior is influenced by differences in geography, regional cuisines and ethnic tastes, cold chain development, retail trends, and disposable incomes. Consider an initial strategy that starts small and focuses on building a regional network of contacts anchored in a major city, such as Beijing, Shanghai, Guangzhou, Shenyang, or Chengdu. Identify second-tier cities that have commercial ties with these larger regional anchor cities. Finally, consider which sectors (e.g., retail, wholesale, e-commerce, HRI) to target first.
3. *Link your established contacts with second-tier importers and distributors.* Although they can sometimes view each other as competitors, most importers and distributors welcome the chance to meet and work with each other. Marketing activities in second-tier cities are usually less expensive than those held in first-tier cities, and new partners are more willing to engage. Many national trade associations have branch or affiliate organizations in second-tier cities. For those exporters who have established contacts in first-tier cities, your contacts would most likely welcome efforts to link them with second-tier city contacts. Planning one-on-one meetings or networking events at large trade shows is also a great way to connect larger importers with new second-tier city distributors. Business partners in second-tier cities are likely to be more eager

and willing to hold events than importers in first-tier cities where promotion costs are higher and schedules are more hectic.

4. Work with regional FAS Agricultural Trade Offices to identify promising second-tier cities. FAS Agricultural Trade Offices (ATOs) are in China to assist and advise U.S. exporters on how to expand into second-tier cities. For more information about specific second-tier city opportunities, please contact one or more of the five ATOs (listed below) who are responsible for trade promotion and market intelligence in their respective regions.

The Future is Here – Why It's Easier Now to Conduct Business in Second-tier Cities

When U.S. food and agricultural exports to China expanded beginning around 2005, first-tier cities were the only cities with the distribution and cold chain capabilities to get fresh imported foods to consumers, processors, and manufacturers. Since then, cold chain and logistics have significantly improved due to better technology, training, and consumer demands for safe and fresh food. Whereas in the past imported food and agricultural products would enter coastal ports and pass through first-tier city importers, second-tier city businesses are now seeking to make direct connections with exporters.

Second-tier cities now have enough demand, cold chain infrastructure, and distribution networks, including direct flights from the United States to deliver fresh U.S. foods to consumers within hours. Consumers who have become accustomed to the convenience of shopping online are also increasingly likely to expect food imports to arrive fresh, which can be problematic when they are first transported through first-tier city markets.



Figures 1 and 2. As a second-tier city, Lanzhou (left) is the capital and largest city of Gansu Province. Located along the banks of the Yellow River, it is a major commercial hub for the Northwest. Kunming (right) is the capital and largest city of Yunnan province in Southwest China.

It is easier now to not only explore, but also to export directly, to second-tier cities as China continues to complete major air, rail, and seaport investments. Air freight is becoming more reliable and flights more frequent to second-tier cities. Local governments frequently offer air freight subsidies and other incentives to carriers to take advantage of recently built airports. Zhengzhou's Xinzheng International

Airport designated six air freight terminals for imported fruit, frozen and fresh seafood, meat, and live cattle, and is the top destination for U.S. cherries due to favorable air freight rates. Passenger air travel has also vastly increased in the past 10 years. According to the Civil Aviation Administration of China, airlines collectively carried 589 million passengers, to or within China in 2017, an increase of 42 percent from 2013. Chinese carriers are expected to serve more passengers than U.S. registered carriers by 2025.

Several Chinese airlines have begun to fly direct nonstop services to the United States from second-tier cities, such as Chengdu, Xi'an, and Shenyang. Domestic air passenger capacity has doubled since 2010, and domestic routes have nearly tripled⁵ meaning there are now more direct nonstop flights to or between second-tier cities. Finally, China operates the world's longest, and most extensively used, high speed railway network in the world, with speeds ranging from 250 to 350 km/h. The network reached an estimated 18,000 miles and accounts for two-thirds of the world's high speed rail capacity. It is now much easier to visit second-tier cities with high speed rail or domestic nonstop flights averaging two hours between first-tier cities and most second-tier cities (Figure 3).



Figure 3. Major second-tier cities (blue), first-tier cities (red), and selected transportation times between cities.

Conclusions

As China's economy and consumer behavior matures, second-tier cities present new growth prospects for U.S. food and agricultural exporters. These cities are now easier to visit, consumers are increasingly

⁵ <https://www.wsj.com/articles/engine-trouble-chinese-airline-mishaps-put-spotlight-on-pilots-1543055400>

able and willing to upgrade consumption, and cold chain and logistics have improved enough to make these cities viable destinations for imported food products. U.S. exporters are encouraged to consider a targeted second-tier city market entry strategy that appreciates regional differences, starts out small, and links established contacts with new potential second-tier city partners. For more information about promising second-tier cities, please contact the ATOs according to your region(s) of interest:

Northeast China

- Potential second-tier city opportunities: Shenyang, Dalian, Harbin, Changchun
- Second-tier direct flights to the United States: Shenyang to Los Angeles (China Southern)
- Major Port: Dalian

For more information about Northeast China, contact:

ATO Shenyang

North Media International Tower, Suite 1903
No 167, Qing Nian St., Shenhe District, Shenyang, 110014
atoshenyang@fas.usda.gov

North and Northwest China

- Potential second-tier city opportunities: Tianjin, Jinan, Qingdao, Xi'an, Lanzhou, and Zhengzhou
- Second-tier direct flights to the United States: Xi'an to Los Angeles (Hainan Airlines); Qingdao to Los Angeles (Xiamen Air)
- Major Ports: Tianjin, Qingdao

For more information about North and Northwest China, contact:

ATO Beijing

American Embassy
No 55 An Jia Lou Lu Road
Chaoyang District, Beijing, China 100600
atobeijing@fas.usda.gov

East China

- Potential second-tier city opportunities: Hangzhou, Wuhan, Nanjing, Suzhou, Ningbo
- Second-tier direct flights to the United States: Hangzhou to Los Angeles (Sichuan Airlines); Wuhan to San Francisco (China Southern)
- Major Ports: Shanghai, Ningbo

For more information about East China, contact:

ATO Shanghai

Shanghai Center, Suite 331
1376 Nanjing West Road, Shanghai, China 200040

atoshanghai@fas.usda.gov

Southwest China

- Potential second-tier city opportunities: Chongqing, Kunming, Guiyang
- Second-tier direct flights to the United States: Chengdu to San Francisco (United Airlines); Chengdu to Los Angeles (Hainan Airlines)

For more information about Southwest China, contact:

ATO Chengdu

Western Tower, Suite 1222

No. 19 4th Section, South Renmin Road, Chengdu, China 610041

atochengdu@fas.usda.gov

South China

Potential second-tier city opportunities: Changsha, Dongguan, Xiamen, Fuzhou

Direct Flights to the United States: Xiamen to Los Angeles (Xiamen Air)

Major Ports: Guangzhou, Shenzhen, Xiamen

For more information about South China, contact:

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